# THE TRADETech

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Preview edition

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EXCHANGE COMPETITION

# Cosy duopoly or a fair fight?

## Trading venue heads deliver their *cris de coeur* ahead of TradeTech's return to Paris

**Prepared for battle**
Clockwise from top left: Mark Hemsley, CEO, BATS Chi-X Europe; Alasdair Haynes, CEO, Aquis Exchange; Robert Barnes, CEO, Turquoise; Brian Schwieger, head of equities, London Stock Exchange Group.

Ask the London Stock Exchange Group (LSEG), BATS Chi-X Europe, Turquoise and recently launched Aquis about the level of exchange competition in European equities, and you're likely to get a slightly different answer from each one of them.

Alasdair Haynes, CEO of Aquis Exchange, which went live last November, says: "There really isn't any competition," referring to what he calls a duopoly in European equities between national incumbent exchanges and BATS Chi-X Europe, which gained recognised investment exchange status in May last year. Mark Hemsley, CEO of BATS Chi-X Europe, on the other hand, says there is considerable competition in European equities trading. He refutes the suggestion that European equities has become a duopoly, asserting that there are three venues competing fiercely for business in largely European markets such as the UK. "Then there are smaller pan-European players like Equiduct and a number of dark pools, including broker-run dark pools," Hemsley says.

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REGULATION

# MiFID drags industry into the light

## Restrictions on trading in the dark raise liquidity fears for investors

With an update to 2007's Markets in Financial Instruments Directive, dubbed MiFID II, finally agreed by European politicians in January, many delegates at TradeTech this year are already considering the wider implications the new rules will have on the industry and how these political agreements can be translated into workable regulation.

Full details of the legislation that will underpin MiFID II have, at the time of going to press, yet to be released by the European Commission, but their publication will herald the beginning of its 'level 2' stage of implementation.

Level 2 will involve supra-national regulator the European Securities and Markets Authority (ESMA) consulting on how the various components of the regulation will be implemented in practice. A discussion paper is expected to be published shortly after the Commission finalises the legislation, which will then be followed by a consultation paper to obtain industry feedback on ESMA's proposed regulatory technical standards.

Perhaps the thorniest issue to be tackled by ESMA is the introduction of caps on dark pool trading. Throughout the drafting of the legislation, a desire by politicians to reduce dark activity has been met with resistance from the industry. But in order to gain an agreement before the European Parliament breaks up for elections to be held in May, a controversial fixed cap was agreed.

Trading on multilateral trading facilities that use either the reference price or negotiated price pre-trade price transparency waiver for any particular stock is to be limited to no more than 4% of total trading volume on a particular venue and 8% across European markets as a whole, though there is considerable uncertainty over how this will be measured and implemented in practice.

### Trumped by transparency

Juan Pablo Urrutia, European general counsel for agency broker ITG, outlines the industry's main objection to the caps: "We believe that MIFID II is too restrictive on dark trading and that the directive has prioritised market transparency over the needs of end-investors."

For the buy-side, a cap on dark trading could potentially result in increased trading costs as the ability to gain price improvement and reduce market impact (the main reasons asset managers use dark

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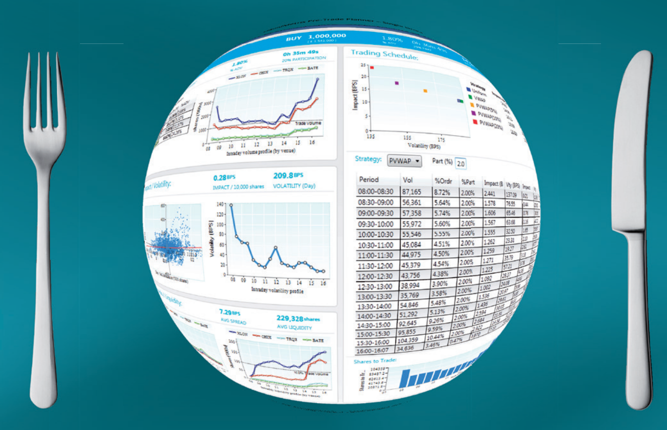
# Fuel For Your Algos?



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**Cosy duopoly or a fair fight?**

◄ *continued from page 1*

## An enemy within?

Having viewed the European equities landscape from the other side of the fence as European head of algorithmic execution at Bank of America Merrill Lynch, Brian Schwieger, who joined the LSEG as head of equities in August, believes there is healthy competition among exchanges in Europe right now. Europe may not boast as many venues as the United States, but Schwieger says there are enough to stoke competition and insists incumbent stock exchanges are keenly aware of the pressure. "If you stop paying attention to your clients your market share can disappear. It's definitely a competitive landscape; we never take that for granted."

LSEG is in the unusual position of having to compete with a multilateral trading facility (MTF) – Turquoise – in which it also holds a majority stake, alongside around a dozen large brokers. "There is clearly competition between us," says Schwieger, "as Turquoise has a healthy market share in UK equities." But being part of the same group, he adds, also means there are opportunities for cross-selling and the cross-pollination of ideas.

Robert Barnes, CEO of Turquoise since Q3 2013, says the MTF is now the fastest growing platform in Europe, having recently increased its share of trading

"Customers feel more comfortable in Turquoise Uncross as they can leave larger orders for longer."

Robert Barnes, CEO, Turquoise

in UK blue chips and less liquid mid-cap stocks. "In February, we set a new record of €3 billion a day for value traded across continental Europe. This is a result of institutional traders coming into European equities," he says. Turquoise recently added 800 small-cap stocks in continental European names to its trading universe.

Barnes believes Turquoise's Dark Midpoint order book has been a key competitive differentiator. It prioritises orders by size, so larger orders jump to the front of the queue, while mid-point matching encourages trading in less-liquid stocks. Within Dark Midpoint is Turquoise Uncross, a service which provides intraday randomised uncrossing events designed to appeal to institutional investors' desire for higher quality and larger sizes that match with price improvement at mid-point. The 'window of randomness' is long enough to make latency arbitrage strategies unviable. Barnes describes Uncross as an open access liquidity mechanism that is optimised for more patient flow. "Customers feel more comfortable as they can leave larger orders for longer," he says, claiming daily trading turnover in Turquoise Uncross has increased more than threefold.

## Room to manoeuvre

In a November 2013 report, 'All Change At The Exchange', Rebecca Healey, a European-based analyst with TABB Group, says Turquoise has been transformed from a "minnow" into one of Europe's fastest growing venues. "Some perceive trading activity on exchanges to be potentially toxic because of high-frequency trading (HFT)," she explains. "Turquoise developed a new order type, a random crossing engine, which doesn't provide any real incentives for HFT firms to get involved. It is creating a new volume that people want to participate in."

Healey says the likes of Turquoise, BATS Chi-X Europe, and Aquis Exchange are pushing change across the European equities industry. Schwieger believes more change will come as a result of MiFID II, which he says will force broker crossing networks (BCNs) and dark pools to come up with different ways of trading.

Other national stock exchanges are taking somewhat different approaches to competition. In her report, Healey refers to the Warsaw Stock Exchange, which she says has "achieved rapid recent growth by focusing on IPOs and a diverse revenue stream". WSE also has a stake in Haynes' new Aquis Exchange, which aims to introduce a new equities trading and market data pricing model. In the face of increased competition and lower margins and volumes in equities, Healey says "higher-margin exchange groups" have diversified away from equity-related transactions into clearing and technology (including analytics and risk management), commodity and fixed interest rate derivatives.

Despite some segments of the market writing off equities, Schwieger believes there is still a lot of scope for innovation as the market looks towards implementing MiFID II. "Some of the new constraints MiFID II imposes will change the way algorithms and people trade," he says. In response to dark volume

"We have a clear vision of what we want to do with market data based on an all-you-can-eat model."

Alasdair Haynes, CEO, Aquis Exchange

"It would be useful if there was more competition around the auction, but it is a difficult problem to solve."

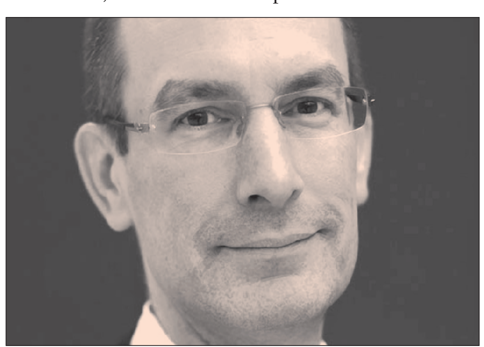
Mark Hemsley, CEO, BATS Chi-X Europe

caps and the elimination of BCNs under MiFID II, Schwieger says the LSEG is exploring the idea of an intraday auction. Competition in the equities space, he says, is no longer about price but about innovation. Intraday auctions, says Schwieger, are an opportunity to provide the sell-side with the building blocks they need to provide new services to the buy-side.

## Digesting data

But for Haynes of Aquis Exchange, which plans to bring a new "all-you-can-eat" pricing model to trading execution and market data, pricing competition in European equities is far from over. "A subscription-based pricing model changes the landscape for market data," says Haynes. "The standard mechanisms for market data charge by terminal usage but in a very antiquated, inefficient way. We have a clear vision of what we want to do with market data based on an all-you-can-eat model for data. We're already in discussions with half a dozen banks, brokers and exchanges."

Hemsley of BATS Chi-X Europe agrees that there needs to be more competition in the area of market data and auction pricing. "There really isn't competition in the auctions space, which remains the remit of the national exchanges. In turn, this feeds into market data – the market doesn't want multiple closing prices or auctions that come up with lots of different prices. It would be useful if there was more competition around the auction, but it is a difficult problem to solve."



"Some of the new constraints MiFID II imposes will change the way algorithms and people trade."

Brian Schwieger, head of equities, London Stock Exchange Group

Schwieger agrees market data is a complex issue due the multiple links involved between venues and market participants, which can add to margins considerably. While subscription-based pricing as proposed by Haynes may appeal to certain segments of the industry, part of the challenge any new venue faces, says Schwieger is getting seed liquidity.

As the new kid on the block, Haynes realises he has to play catch up with the already established equity trading platforms. "We are already getting small percentages of individual blue chip stocks, so we are not the smallest exchange," he says. "People are supportive of what we are doing but it will take time for people to come on board." Hemsley says the market will always listen to new ideas but only if they address a real rather than a perceived problem. "I don't think many firms perceive the price of trading to be the problem at present. It's more the price of market data and auctions. That's the real problem." ●

## TO LEARN MORE...

**Keynote: A new chapter for Europe – Dominique Cerutti, CEO, Euronext**

8 April – 08:40-08:50

**Panel: The future of venues – how will venues attract flow going forward?**

8 April – 16:10-16:50

# Taking the low road?

## Trading volumes are falling. Natural crosses are hard to find. Electronic has superseded human for the first time. So what will brokers' differing coverage models deliver to the buy-side?

Since the financial crisis of 2008, equity trading volumes have lurched on a downward path. US equity volumes hit their lowest ever monthly figure in five years last August, with 30% fewer trades than the 2007 average. Dwindling volumes, coupled with tighter broker margins, means that investors are fishing in ever shrinking liquidity pools.

"Post-crisis, you have seen a long-term decline in real investor liquidity," says Richard Balarkas, managing director at Quendon Consulting and former CEO of Instinet Europe. "Large blocks have moved out of the market. The markets are designed for very small trades and the ability to find blocks has not been made easier."

As brokers and banks cut back on their equities staff – employees on equities desks fell by 8.5% last year globally according to figures by analytics firm Coalition – low-touch electronic trading has become the main point of focus.

Last year, European investors put 51% of their equity orders through electronic routes, according to a study by research consultancy TABB Group, 'European equity trading 2014: Low-touch domination takes off'.

The growth in low-touch trading has directly impacted the investor-broker relationship. The TABB study said more than 60% of the buy-side is now selecting algorithms according to strategy, not the underlying broker, while 55% of the buy-side intends to increase algorithm usage this year. At the same time low-touch channels in 2014 are anticipated to receive more than 40% of the commission wallet for the first time, jumping from 35% to 42%.

### Best execution

The swathe of buy-side participants embracing technological change is only growing, with the understanding that algorithms are for much more than simple order flow. From a buy-side perspective, the issues impacting the choice between low- versus high-touch trading are quite distinct.

"We will continually adapt to the changing market structure and build for scale to achieve best execution for clients."

Brian Pomraning, head of electronic client solutions, EMEA, J.P. Morgan

"In the high-touch business, more capital commitment and market colour is required," says Brian Pomraning, head of electronic client solutions, EMEA, J.P. Morgan. "Sales traders provide information on stocks, the order flow in the bank and liquidity in names. Low-touch is often a discussion about product feature, functions, and behaviours. For example, how to set various parameters to drive an algorithm, appropriate participation rates or how to access liquidity."

J.P. Morgan has invested heavily in its electronic trading platform over the past three years and is now vying for market share with the established market leaders. Despite the pressures on the business, Pomraning remains bullish about his own bank's ability to compete. He says that, electronic or not, the number one priority remains best execution, which means minimal slippage and controlling market impact. "Rate compression has been going on for years," he says. "I don't view this as a threat to the long-term viability to the business. We will continually adapt to the changing market structure and build for scale to achieve best execution for clients."

Trades requiring human involvement currently cost almost twice that for computer trades, which has also swung momentum. But Duncan Higgins, director, head of electronic sales EMEA, at ITG, says that cost is of lesser importance to clients when weighing up execution options.

"A significant benefit of the electronic side is anonymity and decreased information leakage. Cost is less of a factor. Traders are able to balance costs in different ways – they can trade on an execution-only basis with high touch, which lowers the rate."

And Higgins doesn't believe that low-touch trading has put an end to the unique contribution of the sales trader. "One ability of the high-touch trader is to go out to clients who aren't trading a stock and generate an order from a portfolio manager," he says. "It's very complex to replicate this electronically. Clients have longstanding relationships with sales traders and would hope another person they trust doesn't leave the industry because of the drive towards efficiency."

### Compromising positions?

With all this flux, banks and brokers have been looking to distinguish themselves to get ahead of their rivals. In recent times many have been combining their low- and high-touch businesses in order to hone efficiency. It might be what the market wants – a survey last year by consultancy Woodbine Associates of 41 US asset managers found that nearly two thirds of buy-siders preferred an integrated option – but not everyone agrees that this is the way forward. For one, it could compromise another key tenet of electronic trading – anonymity.

"Different brokers have tried to run multiple services with a single point of contact which hasn't gone down well with clients," says Higgins. "One of the priorities of electronic trading is anonymity, so why would you have such sensitive orders seen by a sales trading desk at the same time?"

Some brokers are offering pre- and post-trade analytics services as a way of providing greater value to clients. But this data isn't always useful, says Balarkas.

"There are problems in its presentation – whether or not it is distorted by embedded outliers; understanding the benchmarking models; whether it can be trusted to be accurate. These longstanding issues mean that many clients still cannot use it as a basis to adjust how they trade and improve their performance," he observes.

"Firms will have to decide whether they are experts in trading or research. At current volumes, there are few who will do both profitably."

Richard Balarkas, managing director, Quendon Consulting

### Long-term sustainability

Tim Wildenberg, chief executive at execution broker Neonet Securities, says only a few big banks can claim to be pure neutral execution agents, and much of their business is generated from relationships and capabilities that have little to do with execution capabilities.

"A lot of the bigger banks get their flow because of other areas of expertise."

Tim Wildenberg, chief executive, Neonet Securities

"Different brokers have tried to run multiple services with a single point of contact which hasn't gone down well with clients."

Duncan Higgins, head of electronic sales, EMEA, ITG

"A lot of the bigger banks get their flow because of other areas of expertise, like the research they provide or because the client owes them money from another part of the business," he says.

Wildenberg feels that choosing whether to go electronic or the human route depends on the kind of trade being done, with more complex trades invariably requiring the experience and skills of a sales trader.

Whilst it seems there are arguments in favour of a long future of coexistence between low- and high-touch trading capabilities – separated by Chinese walls or not – much may depend on the future relationship between research and execution, which is set to be revolutionised in the next few years as regulators seek to separate research and trading fees. The UK's Financial Conduct Authority (FCA) is currently looking at how to prohibit asset managers from using dealing commissions to finance research services. Separation of the two will add further pressure to many.

"Firms will have to decide whether they are experts in trading or research," says Balarkas. "At current volumes, there are few who will do both profitably. You could see capacity coming out of the market and in light of the FCA review of commission spend I question the long-term sustainability of many of the models." ●

### TO LEARN MORE…

**The big debate: High-touch trading in less liquid stock is the only future of trading**
8 April – 12:30-13:00

**Creating an optimal trader/broker partnership**
8 April – 14:00-14:20

**Integrating high- and low-touch services as a one-stop shop**
8 April – 14:20-15:00

**Panel: Is coverage still king? How should the broker service model change to integrate high- and low-touch tools and to meet trader' needs?**
9 April – 10:30-11:10

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www.thetradenews.com
Publisher: John Lee +44 (0) 20 7397 3823 jon.lee@thetrade.ltd.uk
Editor: Chris Hall +44 (0) 20 7397 3819 chris.hall@thetrade.ltd.uk
Editorial team:
John Bakie +44 (0) 20 7397 3817 John.bakie@information-partners.com
Paloma Migone +44 (0) 20 7397 3815 paloma.migone@information-partners.com
Richard Henderson +44 (0) 20 7397 3820 richard.henderson@information-partners.com

Advertising & Marketing:
Françoise César +44 (0) 20 7397 3821 francoise@thetrade.ltd.uk
Marc Carolissen +44 (0) 20 7397 3807 marc.carolissen@thetrade.ltd.uk
Nick Kidson +44 (0) 20 7397 3822 nick.kidson@thetrade.ltd.uk
Graphic Design:
Tina Eldred +44 (0) 7540 972 442 tina@eldreddesign.co.uk

The Trade Ltd, Upper Ground Floor South,
200 Aldersgate Street, London EC1A 4HD
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# In pursuit of a moving target

With new regulation putting a strain on banks' ability to provide block liquidity, Fabien Oreve, global head of trading at Candriam Investors Group (and TradeTech panellist), discusses how the buy-side should adapt its trading strategies

### What are your biggest liquidity challenges and how have they evolved in recent years?

Over the past few years, we have seen some changes to market dynamics due to the increased presence of electronic trading. Today, any equity order greater than 5% ADV can cause a significant impact in the market and needs to be handled with great attention. Pre-crisis, working an order with a static 25% of volume participation algorithm was common. Now, with the increasing use of liquidity-seeking algorithms, we are seeing more dynamic and sophisticated execution strategies. Block trading with or without technology has been a very popular way of coping with liquidity challenges, especially in the small- and mid-cap segment. But, over recent years, with the sophistication of portfolio trading (PT) tools, passive execution across dark pools has increased as it helps minimise the risk of market impact more systematically. This has become an essential way to trade some lists of orders efficiently, at low transaction costs.

### Are lower volumes/lower liquidity levels a permanent part of the European trading environment now and if so how should the buy-side respond?

Since 2009, declines in volumes and liquidity have not followed a linear trajectory. Lower volumes have not impacted any market participant and any trading venue in the same way. Over the same period, cash equity volumes from traditional asset managers have decreased relatively but volumes from exchange-traded funds (ETFs) have increased. In particular, ETFs have positively affected liquidity at the market close. Liquidity from high-frequency trading has also significantly increased intraday. As a result, dark pools have attracted more institutional liquidity at the expense of the traditional lit order books. A strong start to 2014 suggests the lower equity volumes of recent years are not permanent. Buy-side trading desks have to adapt to changes. Gaining control over the access to liquidity is a great move, but not an end in itself. Buy-side traders have to get even closer to portfolio managers (PMs). They need to understand PMs' evolving investment strategies, for example those who moved away from traditional index-tracking to smart beta strategies. At Candriam, the trading desk is integrated with the firm's investment managers, which makes us well exposed to any changes in requirements. For example, our traders recently sat down with our PMs to discuss how to tackle the liquidity risks associated with trading certain illiquid names.

### What changes have you made internally to improve efficiency in the quest for liquidity?

In the first instance, traders should know internal clients better. As mentioned before, we are working closer with PMs. By identifying 'high conviction' PMs, as we have, traders know if they have to find liquidity for the full size of the order quickly or not. Stock-picking strategies, which involve small- and mid-cap stocks, typically require block trading in a crossing network or the skills of a sales trader. It is a different story for quantitative investment strategies, which periodically generate large lists of orders. PT offers more opportunities to hedge and trade some illiquid names with algorithms than single-stock trading. The second thing the buy-side should do is update their execution process and technology. Candriam has a 15-page internal document that is updated every six months, giving traders guidelines on what they should do to improve efficiency.

We've also defined different criteria for direct execution of equity orders from our order management system (OMS)/execution management system (EMS) with brokers' algorithms. Easy orders are automated with these tools, but the most difficult orders are handled carefully by brokers' high-touch desks. For large single orders in small- and mid-cap stocks, we have identified some local brokers who can tap into existing and potential liquidity. However, when we have to work large caps in size early in the morning, the skills of a sales trader are not always sufficient. Today, we can use a dark-liquidity-seeking algorithm from a broker who customised the order routing strategy per our request. This demonstrates how technology can greatly help us at a particular point in time.

### How does technology and transaction cost analysis (TCA) come into play?

Today, you cannot separate the execution process from technology and TCA, especially real-time TCA. We monitor trades in real time via our OMS/EMS technology. If we want to accelerate the execution, trade a block against a natural interest or a risk desk later in a morning, we can stop the order placed in the dark, send the partial execution down to the middle office, then send the order balance to a sales trader. This flexible approach to trading is increasingly important in our experience. Over the last three years, we have persistently tried to optimise the combination of automated tools and human trading with the objective of reducing transaction costs.

"We have persistently tried to optimise the combination of automated tools and human trading."

Fabien Oreve, global head of trading, Candriam Investors Group

### How has the prevailing liquidity environment shaped your requirements of brokers?

As an asset manager, we have a responsibility to ensure that our relationship with large brokers is very good. We have to concentrate volumes on fewer counterparties. This doesn't mean we've stopped working with local specialists. We have identified some who we think bring value to the execution performance in certain regions. More recently, we have also been more selective about the brokers that specialise in PT. Today, my desk can measure the ability of PT desks to maximise crossing with unsolicited liquidity in the most difficult names.

### What impact might incoming regulations have on the search for liquidity?

The most concerning piece of regulation because of its impact on liquidity is the proposed restriction of dark pools, i.e. the 4% cap on trading a security in a dark pool and the 8% limit of total market volume. This restriction could reduce European liquidity and result in higher trading costs, especially in small- and mid-cap names. Basel III capital rules have also made block trading in equities with large banks more difficult and expensive. Regulation should be implemented to increase transparency, but not at the expense of liquidity. The cap mechanism that has been proposed is unrealistic, because today you don't precisely know what the total volume is. Regulators should be focusing on post-trade transparency and the creation of a single consolidated tape in Europe. Trading in dark pools is a necessity for institutional investors to work orders today.

**TO LEARN MORE...**

**Panel: The quest for liquidity: how can the market achieve stable, bright liquidity in equities?**

8 April – 09:10-09:50

**MiFID drags industry into the light**

◀ *continued from page 1*

pools) will be limited once a stock reaches or comes close to its cap.

Mike Seigne, co-head of electronic trading for EMEA at Goldman Sachs, says the market's biggest fear is a loss of liquidity as a result of curbing dark trading, particularly among SMEs.

"Dark pool caps may make it hard to trade in small- and mid-cap names and this is not conducive to helping improve liquidity in markets," he explains. Of particular concern is how the legislation will impact trading in blocks. As automation of trading has gradually worn down average trade sizes in lit markets, the buy-side has overwhelmingly opted to use dark pools for dealing in blocks, so as to reduce the risk of adversely moving a stock price by making a large order public.

For Seigne, maintaining liquidity for block trades is a top priority: "The biggest concern for our clients is the potential for MiFID II to disrupt their access to liquidity. We need to think how we can continue to service clients who want to trade in blocks and give them access to the capital they need."

"The biggest concern for our clients is the potential for MiFID II to disrupt their access to liquidity."

Mike Seigne, co-head of electronic trading, EMEA, Goldman Sachs

## Waive goodbye?

As a concession to buy-side concerns, legislators have indicated that they wish to maintain the ability of investors to continue trading in blocks through changes being made to pre-trade transparency waivers. The waivers, which enable dark pool trading to take place, were seen by politicians as being too widely used and the new rules will require firms using the reference price waiver to prove they were able to achieve price improvement around the mid-point.

However, the large-in-size waiver, which allows market participants to avoid pre-trade transparency requirements if their order represents a significant chunk of a share's daily traded volume, will remain untouched.

Per Lovén, head of international corporate strategy at block trading platform Liquidnet Europe, welcomed the changes to waivers, saying: "Dark pools were created to offer price improvement and/or minimise market impact. The model of requiring price improvement has been adopted most recently in Australia and this has been positive for both the lit book, block and mid-point trading."

Some have questioned whether further improvements could be made to the large-in-scale waiver to increase its uptake. The current threshold for large-in-scale waivers varies between 1% of turnover for orders where average daily turnover in a stock is more than €50 million to 10% for orders with a turnover of €500,000.

Rob Boardman, CEO of agency broker ITG Europe, argues MiFID II should also review these thresholds but is doubtful the political will exists to make it a reality. "We would welcome an adjustment to the large-in-scale waiver but I think political issues will get in the way of this," he says. "The direction of travel in Brussels is towards reducing the amount of trading taking place in the dark and lowering the large-in-scale threshold would go against that."

## Loss of discretion

Another factor that could impact block trading is the end of broker crossing networks (BCNs). Under MiFID II, a new category of regulated trading platform, the organised trading facility (OTF) is to be created and BCNs will no longer be able to operate. However, OTFs will not be used to trade equities, effectively banning BCNs in Europe.

BCNs have been one of the major vehicles for block trades, enabling brokers to handle client orders with discretion to ensure they can make suitable matches to complete orders while minimising information leakage. Several brokers are currently consulting with their buy-side clients on how to fill the gap left by the loss of BCNs and how they can help their clients to trade blocks effectively in the post-MiFID II world.

Although controversial, dark trading is just one part of MiFID II and the regulation is set to have a broad impact across many asset classes and market infrastructures in Europe. However, with sourcing liquidity consistently listed as one of the top concerns of asset managers, dark pool regulation will likely be a dominant theme at this year's TradeTech. ●

## TO LEARN MORE…

**Panel: How will trading in the dark evolve post–MiFIR?**
8 April – 11:50-12:30

**Bringing equity trading back on to lit markets: the case for transparency**
8 April – 14:00-14:20

**Panel: Dark pool detox: Value vs Toxicity**
8 April – 16:10-16:50

**Implementing MiFIR: the regulator's priorities for asset managers, banks and exchanges**
9 April – 12:10-13:00

# London calling for reform, but is the world listening?

## The UK's regulator is determined to make the research market truly transparent and competitive and wants the rest of the world to follow its lead

UK regulator the Financial Conduct Authority (FCA) has been pioneering efforts to reform the brokerage industry by creating a clearer delineation between payments for research and execution. But while asset managers have shown some desire to achieve more transparency on costs, the road to fully unbundled services is littered with obstacles.

The FCA's desire to change the way the research market works has been growing for some time. While concerns about how the buy-side pay for broker research can be traced at least as far back as the Myners report (published in the same year as the first TradeTech), a renewed assault began in November 2012 when its predecessor, the Financial Services Authority, sent a 'Dear CEO' letter to asset managers warning them to better manage and remove a range of potential conflicts of interest in their business, including receipt of corporate hospitality.

The use of bundled corporate access, research and execution services paid for through a single commission channel was highlighted as one area the regulator was keen to reform. Almost a year later, FCA chief executive Martin Wheatley announced at the regulator's annual asset management conference a consultation paper and thematic review on proposals to change the research market in order to increase transparency, provide better value for clients and improve the quality of research provision.

Since then, industry opinion has varied on the potential impact of the FCA's campaign. Some have pointed to growing use of commission sharing agreements (CSAs), which enable asset managers to use execution commissions to pay for independent research services, as evidence the industry is already moving in this direction and the FCA is playing catch-up.

> "There could be some merit in an industry initiative to create 'FIX for research'."
>
> Stephen McGoldrick, director, market structure, Deutsche Bank

However many, particularly in the brokerage business, see this as a fundamental change to the way they do business. "The FCA review may result in material changes to the current business models and it is important that the industry gives coherent feedback on this to create a workable solution implemented across not just Europe but globally," says Stephen McGoldrick, director of market structure at Deutsche Bank.

In its paper, 'CP13/17 – Consultation on the use of dealing commission rules', the FCA made a number of proposals focused primarily on requiring asset managers to ensure they are using client money responsibly when paying for research through commissions. It called for them to make clear how much they pay for research separately from the costs of execution and to ensure they only paid for research they were using.

### The burden of proof

Norman Hartmann, CEO of AQX Securities, a specialist execution broker spun out from a buy-side trading desk, says the current way the research market works has burdened investors with excessive costs.

"The average UK investor is losing £8,000 over the life of their investments through overpaying for research so the market needs to change," he explains.

For asset managers, the main concern is to be able to provide the regulator with evidence of good practice, which could be problematic in some cases, according to Hartmann.

"For written research, it's fairly easy to show you received a document and you paid a certain amount for it, but not all research is delivered in this way," he says. "If you have a call with an analyst to talk about a stock then you need a way to record that and allocate an element of your research costs to it."

The challenge then, for brokers and institutional investors, is to agree on a distribution mechanism that ensures buy-side firms receive the research they need in a way that will satisfy the regulator. McGoldrick believes the industry should begin working on developing standardised research distribution methods.

"We need to think about standardising data flows between the buy-side and the sell-side to ensure investors get the information they need to evidence their conflict management and research departments get information on value and usage of research. There could be some merit in an industry initiative to create something like 'FIX for research'," he explains.

### Pre-payment problems

While the buy-side has generally been positive about the FCA's work and welcoming of efforts to get better value for end-investors, a number of features of the existing research market can be advantageous, including the ability to pay for research after the event. Under the current system, brokers distribute research widely to their clients. Asset managers then pick the research that best suits their needs and rewards the broker that produced it with execution flow.

In a recent report, UK buy-side trade body the Investment Management Association (IMA), highlighted the problem of moving from this model to one where brokers pay for research after receiving it, saying it is hard to make a judgment on a piece of research's value to a specific portfolio manager in advance.

While the FCA's consultation made clear it considered some bundled services such as corporate access and market data to fall outside its definition of research – and therefore should not be paid for via commissions – it provided less clarity on how firms should deal with pricing of non-printed materials. Of particular concern is how access to analysts will be managed.

"The existing model offers valuable flexibility. For example, direct contact with analysts for the buy-side is a finite resource," says McGoldrick. "If you had to decide in advance how much of an analyst's time to book, you would be guessing how much will be required to discuss as yet unknown market-moving events. Clearly, this would be inefficient."

> "The average UK investor is losing £8,000 over the life of their investments through overpaying for research."
>
> Norman Hartmann, CEO, AQX Securities

> "The industry is on board but wants to see this issue handled sensibly to ensure competitiveness isn't damaged."
>
> Richard Metcalfe, director, regulatory affairs, Investment Management Association

Adoption of FCA proposals would require radical change to existing rules and distribution practices relating to investment research, says McGoldrick. "Regulations require that much of our printed research be disseminated simultaneously to all clients. We welcome the focus on establishing the value of that research but differentiated access, both in terms of timeliness and scope, is a prerequisite," he explains.

### The international angle

While the focus has been on the impact of reform on the UK's asset management and brokerage industries, the FCA has international ambitions, aware that isolating the UK could be damaging. Richard Metcalfe, director of regulatory affairs at the IMA, notes: "What the FCA is working on feeds into a longer-term debate about making sure asset managers can get the best value for their clients. The industry is on board but wants to see this issue handled sensibly to ensure competitiveness isn't damaged."

The risk is that overly onerous restrictions on how research is paid for could lead to excessive costs for institutional investors, ultimately resulting in them shifting their business outside. As such, the FCA has stated it wants to speak to European authorities in Brussels about introducing its reforms as part of MiFID II. "The FCA's approach of pushing this up to the EU level is definitely encouraging and we would hope the rest of the world will follow," Hartmann says.

But US regulators have shown little appetite to change the research industry and the IMA is less confident that other jurisdictions will follow suit, calling on the FCA to bring the issue to the International Organization of Securities Commissions (IOSCO). "This needs to be tackled on a global level to ensure Europe remains competitive," Metcalfe explains, "and we believe the proper place for this debate to take place is at IOSCO so it can drive this forward."

The FCA's consultation closed in February and the results are expected this spring with firmer policy proposals set to follow.

**TO LEARN MORE...**

**Panel: Commission unbundling: how can we achieve a transparent system that delivers value for the end investor?**

8 April – 15:00-15:40

# Complete control for the buy-side?

Asset managers must deepen their understanding of quantitative metrics and rethink broker relationships to improve algorithmic execution

If phase one of buy-side algorithm use centred on automating basic functions and phase two on seeking liquidity, the third phase, according to Saurabh Srivastava, global head of electronic trading for Invesco, is complete control.

By this, he means asset mangers like Invesco should look to develop algo-building capabilities in-house, deploying the skills of specialised quants, akin to the established practice of certain larger hedge funds and high-frequency firms.

"Since the use of electronic trading tools to implement investment decisions has become an important part of the implementation process, one of the ways to realise differentiation at that level is to create your own tools," he says.

Like many buy-side firms, Invesco puts the broker algos it uses through rigorous testing, ranking strategies via post-trade transaction cost analysis. But, as buy-side firms continue to increase their use and knowledge of algos, the next logical step could be to build fully tailored, proprietary tools.

Saurabh Srivastava, global head of electronic trading, Invesco

## Natural extension

Srivastava, who will explore changes to buy-side algo usage in his presentation, 'The new breed of algorithms: Measuring algo performance and risk' at TradeTech in Paris, leads an algo building team that includes two mathematics PhD graduates – one who previously gained experience at a bulge-bracket firm; the other from a high-frequency trading shop.

"Our internal algos for the US market will always be benchmarked against broker algos, covering strategies including implementation shortfall and volume weighted average price. This is a natural extension of the buy-side's role in algorithmic trading," he adds.

Srivastava, whose firm has nearly US$800 million in assets under management, laments the marketing-heavy nature of sell-side algo offerings and says despite greater customisation there is often little difference between competing tool sets.

But, buy-side control does not equate to sell-side detachment.

Relying on brokers to guide asset managers through regulatory, competitive or technological change and quantitatively measure performance will define the future of the relationship between the buy-side and the sell-side, he adds.

"Changes in the market's structure and its complexity mandate that we foster a different type of partnership with the sell-side than we have historically," he says.

Nevertheless, Srivastava insists that, to truly reap the benefits of electronic trading, automation and the scope of quantitative metrics, asset managers must rely on their own resources to decide how to evolve.

"To improve execution quality, the buy-side must adapt and develop competence in being able to mathematically model and quantify different phases of the implementation process," he says.

Reducing the risks associated with algorithmic trading is also a priority for users and developers. Now, for instance, brokers can incorporate functions to pause a large order should a security's price suddenly move unfavourably.

## Algos on alert

Blending greater risk oversight with automation poses an ongoing issue for buy-side algo users at a time when errors with the tools themselves and the markets they access, can cause catastrophic results, warns Srivastava.

The May 2010 flash crash, Knight Capital's 2012 algo error and a Nasdaq market data error that stalled trading for three hours last August are the most high-profile of a string of events in recent years that have highlighted structural market weaknesses.

Other events include a fake post on the hacked account of Associated Press on the social media website Twitter that sent markets spiraling due to the reaction of automated trading tools and a spate of 'mini crashes' driven by low-latency traders that wiped stock prices in seconds only to see them bounce back moments later.

Now, more than ever, Srivastava says, the buy-side must combine the search for liquidity and speed with greater use of risk metrics to avoid being caught out by such market shocks.

But the growth of automation will never fully replace institutional investors' trading desks, suggests Srivastava. The human factor in assessing venue toxicity, managing broker relationships and balancing high- and low-touch strategies will remain key to execution performance.

"Although there may be limited ability in the future to execute small orders in an automated way, orders that may be many multiples of average daily volume will always require human oversight to execute efficiently." ●

**TO LEARN MORE...**

**The new breed of algorithms: Optimisation of trade execution**

8 April – 10:10-10:30

**Panel: From automation to customisation: redefining how traders are using algorithms and next generation trading tools to outperform each other**

8 April – 14:20-15:00

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# Alpha gets social

The use of social media could revolutionise trading for the buy-side in a similar fashion to the introduction of algorithmic trading

The ability to judge the impact of news ahead of the wider market has always been at the heart of alpha generation, but the role of social media in the investment and trading strategies of they buy-side is far from assured.

Paul Hawtin, CEO of hedge fund Cayman Atlantic, is one pioneer from the social media trading set. His fund, launched in October, uses social media data as the basis of its investment strategy.

Hawtin launched the fund after building up US$18 million of investor capital from high net worth individuals. For the last three months of 2013, he achieved returns of 24.77%, benefitting from a healthy finish to the year by the US equity market.

Speaking at TradeTech in Paris this year, Hawtin will discuss the inner workings of his fund's approach to social media, which he believes will revolutionise how the buy-side trades.

"The industry is taking social media more seriously," he says.

"Data from social media will play an increasing role in institutional investing."

Bill Stephenson, head of global trading strategy, Franklin Templeton Investments

## Sentiment at speed

Hawtin's approach breaks social media down into three categories to distill actionable information: global sentiment on markets and sectors; sentiment on individual companies' stock; and event detection based on tweets.

For this final category, Hawtin's bespoke technology monitors key words – for example 'oil spill' for a potential drop in valuations in the petroleum sector or 'assassination' for a market-moving political event – from which his staff will drill down into the post to identify its impact.

Like many hedge funds, Hawtin's Cayman Atlantic has built its own technology to deduce market information from public data. Twitter data, he says, is free to anyone who wants it, meaning a low-latency race will inevitably occur between firms like his, or others, that provide trading-relevant Twitter data to the buy-side.

"In the long term, it will become a race for speed," he says. "The funds that get in first will see the most alpha generation."

But, for now – and potentially for the next decade – Hawtin believes Twitter-focused funds will return profits higher than traditional asset managers who may be unwilling to bet on social media as a key market metric.

As per Cayman Island rules, the fund requires a minimum investment of US$165,000, or £100,000, and targets wealthy individuals rather than institutions. Expanding the investor base, says Hawtin, has been harder than any of the technical aspects of developing his own quantitative 'black box'.

Hawtin notes a difference in the attitudes of potential customers across geographies, as investors in the Middle East, India and Africa have shown a greater willingness to support his strategy compared to those in more mature, perhaps more bruised, Western markets.

"Investors in the US and UK are more cautious about trading based on social media, which I think is linked to the 2008 crisis. This has shifted their focus from chasing alpha to preserving capital."

"The industry is taking social media more seriously."

Paul Hawtin, CEO, Cayman Atlantic

## Change in the AIR

As the use of social media in trading gradually establishes its track record in providing returns and alerting asset managers to information that can shift an asset's value, such geographic elements will likely lessen as ideas will be supported by data.

Bill Stephenson, head of global trading strategy for Franklin Templeton Investments, is another proponent of social media in trading, who argues it has the potential to alter buy-side trading in a similar way to algorithmic trading.

A summit organised by Stephenson in Fort Lauderdale, Florida in February, titled Alpha Innovation Required (AIR), brought together 20 firms that are using technology and innovation to help the buy-side improve returns. Two such firms were focused on helping the buy-side leverage social media information into trading and investment strategies.

"Twitter trading will be one of the most important advances in financial services in the next decade."

Armando Gonzalez, CEO, RavenPack

"Data from social media sources will likely play an increasing role in institutional investing, so asset managers should begin thinking about their social strategy in order to capture and take advantage of the exponential growth of finance-related content," Stephenson says.

For now, most institutional investors remain cautious.

Armando Gonzalez, CEO of news analytics provider RavenPack, who presented at the AIR summit, said so far, institutional investors had shown little willingness to incorporate data from Twitter into trading strategies despite the growing number of products offering the function.

"We don't know of any institutional clients that are trading based on Twitter," he said. "Twitter is still in its infancy for trading, but I believe this will be one of the most important advances in the financial services space in the next decade," he said.

Twitter has emerged as a premier social media site, with more than 100 million active users, including traditional news outlets themselves, posting hundreds of millions of 140-character 'tweets' daily that can influence sentiment on stocks or unveil potentially volatile news, directly from the source.

But, the buy-side has largely remained reliant on established financial data and information providers like Bloomberg and Reuters to source news that affects trading.

"Twitter [posts] cover many events, but not many that are related to stock and economic indicators," Gonzalez said.

## Just one factor

Joe Gits, CEO of Social Market Analytics, the other social media-focused firm at AIR, believes the trend towards incorporating social media in trading and investment strategies will grow, but will form only one segment of the investment process.

His firm automatically monitors more than 50,000 personal and company profiles that it believes will have an impact on stock prices from Twitter and investment-focused social media platform StockTwitz, to provide sentiment information for specific equities.

These profiles, the number of which is increasing by 10% each month, are assessed by his team as influential in altering stock valuations, to block out the noise and focus on turning tweets into actionable investment data.

"We provide a statistical framework showing changes to stock prices," Gits said, adding that social media would continue to develop in importance for asset managers, but would remain just one element of big data for institutional investing.

"Social media is not [an asset manager's trading] model, it's only a factor in the model."

**TO LEARN MORE...**

**Case study: Trading on Twitter: driving alpha through social media-powered algos**

8 April – 16:50-17:15

# Caught between a block and a hard place

Matt Lyons, global trading manager, The Capital Group, unravels the paradoxical choices buy-side traders face when trading blocks

### What themes do you expect to address in your presentation on the opening morning of TradeTech 2014 in Paris?

The focus of my talk will be on the 'trader's dilemma'. A dilemma is defined as a situation requiring a choice between two equally undesirable solutions and I believe this sums up an everyday reality for the buy-side trading desk.

The primary challenge a buy-side trader faces when implementing a portfolio decision is minimising the friction of its implementation. This creates a true dilemma because the trader must choose between increasing market impact by executing aggressively or increasing opportunity risk by employing a passive execution strategy.

Stretching an order over time reduces the market impact associated with demanding liquidity. But, a trader can increase the opportunity risk of the order by pursuing this type of passive strategy if the stock price changes unfavourably.

Conversely, you can reduce opportunity risk by employing an aggressive trading strategy realising a higher market impact and paying a premium for liquidity. The trader's dilemma is about optimising these two competing forces by finding the right balance, while ensuring the trading strategy aligns with the investment thesis.

### What impact does market fragmentation have on the challenges of executing in size?

Fragmentation is a pressing market structure concern facing the buy-side, particularly in the US. There is reason to wonder about the effectiveness of having such a high number of alternative trading systems (ATSs) for US equities and the need for order protection by exchanges that match insignificant amounts of market share.

One of the concerns associated with the growing number of US venues is the propensity to be gamed by predatory trading entities. Information leakage about large imbalances in supply and demand, such as an institutional order, is a key contributor to opportunity risk for a buy-side trade.

ATSs were originally intended to reduce information leakage by offering anonymity and a place where size discovery was possible. But, at some point this potential benefit has diminished as the number of venues has grown. Now, sourcing liquidity can involve accessing dozens of ATSs, which increases the potential for an institutional investor to leave a footprint in the market revealing their intentions.

Information leakage increases as a trader tries to source liquidity and it's hard to ascertain who has seen the orders and what will happen to the security's price as a consequence. Acquiring information about broker routing practices and the venues where orders execute helps a buy-side firm to improve execution quality and align broker practices with an asset manager's goals.

### Overall, has the increase in off-exchange trading helped the buy-side?

There are benefits from some of these market structure changes but also many challenges, which intensifies this core dilemma for the buy-side trader.

Institutional investors want to engage in a space where natural buyers and sellers are brought together to find an equilibrium price. In this sense, the job of a buy-side trader is to source liquidity, find the right price, and negotiate a trade with the optimal strategy for the portfolio's goals.

When you have these latent buyers and sellers lurking in dark pools it's hard to find the block sizes that buy-side firms seek. The fragmentation of liquidity across markets has created a perverse incentive for traders to withhold their intentions when trading in blocks for fear of information leakage and instead park orders in dark pools. This reduces the initial goals that ATSs sought to provide the buy-side.

> "The increase in broker ATSs has reduced the ability to source large block liquidity."
>
> Matt Lyons, global trading manager, The Capital Group

### Does the growth in the number of dark pools risk further reducing the buy-side's ability to execute blocks?

The increase in broker ATSs has reduced the ability to source large block liquidity. Brokers have an incentive to increase their own ATS market share and trading statistics, specifically fill rates and sizes.

This creates a true dilemma for the broker. If they happen to find a large contra side order in another broker's ATS they have no incentive to complete a block if it means routing to the other broker's pool. It would reduce the attractiveness of their statistics while increasing that of their rival. A rational response should be to route only small sizes, reducing the number of large trades, which would result in a lower average execution size in broker ATSs to resemble those of an exchange.

There's a need for commercial solutions to help solve these fundamental dilemmas in efficiently bringing buyers and sellers together, but there are obvious downsides to having such a large number of venues.

### US regulators have recently suggested they will consider reforming high-frequency trading (HFT) – will this impact the buy-side for the better?

Regulators should address the inherent conflicts of interest in the system when addressing a broad issue like HFT, such as the impact of exchange rebates on broker routing practices.

Electronic market making is a crucial element of the market and firms that take on risk even at low latency to make markets liquid should be rewarded. An entity willing to bridge the temporal dislocation between natural buyers and sellers is a necessary ingredient of a market.

The conflicts of interest that exist between for-profit exchanges and a constituent of their clientele that generates large amounts of volumes by trading at low latency can hurt the buy-side. The latency advantages of co-location and use of order types that give certain firms faster access over other participants should be managed with proper regulatory oversight to reduce any unfair advantages that affect end-investors.

Exchanges earn tape revenues by establishing the best bid or offer and they pay rebates to make the best bid or offer whether there is an execution or not. Effectively, they can subsidise those payment rebates through the tape revenue. As such, the economics in this space seems disjointed and it's hard to see whether or not this is beneficial to the end-user.

### How would you characterise the buy-side's reaction to the amount of regulatory change experienced in recent years?

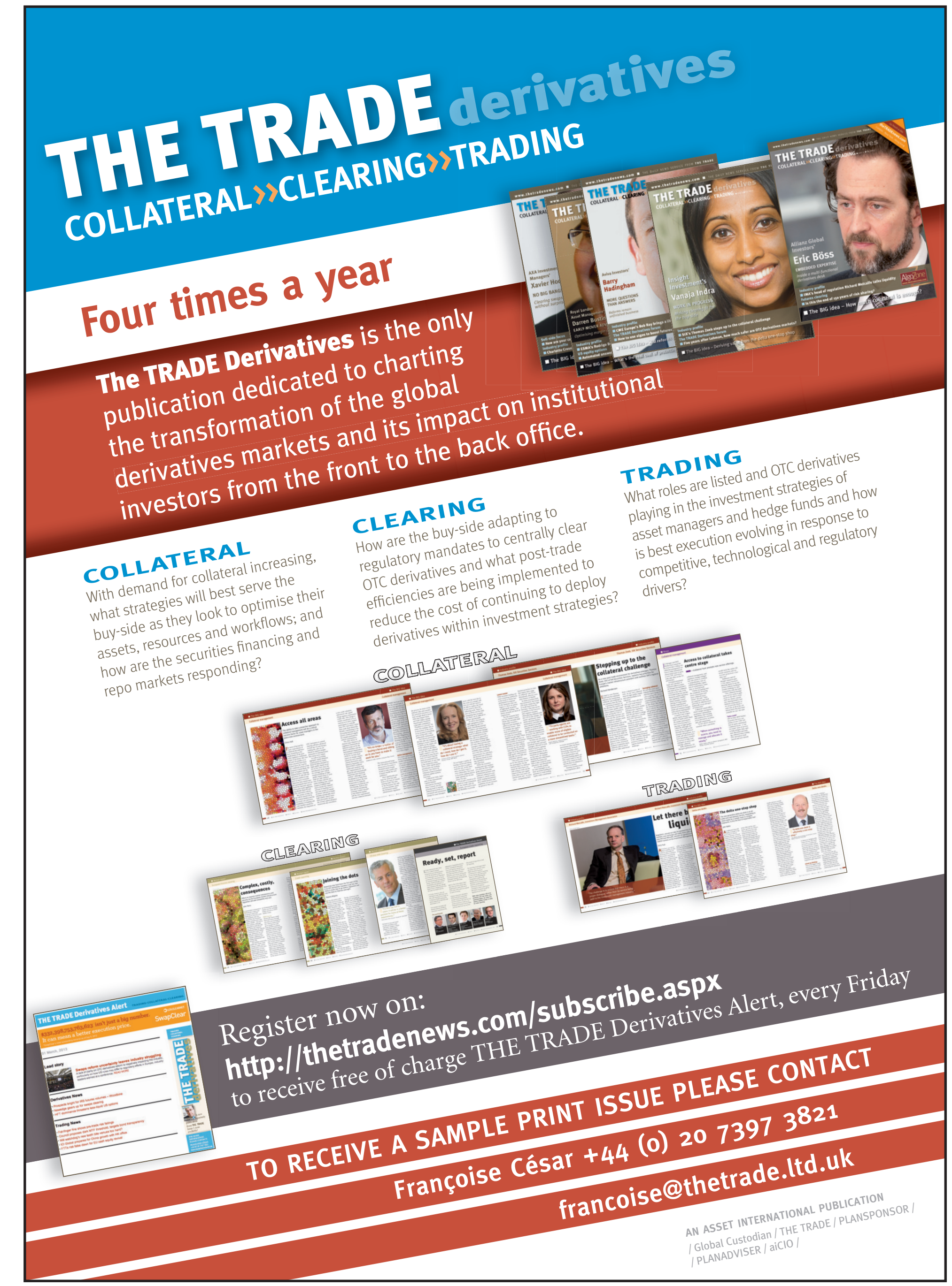
Adapting to new regulation is a fact of life for any asset manager in the US or in any other jurisdiction. The scope for regulators to fix markets is always over-stated and there are unintended consequences that can be seen in initiatives such as Regulation National Market System, which created a number of outcomes that were not planned or anticipated. We should be looking towards commercial solutions to these market structure issues.

On a global basis, regulators have a greater understanding that some of the market structures have fragile elements and are inherently complex. Addressing these issues should be a focus for regulators to ensure markets are robust enough to withstand inevitable shocks that could cripple the system.

**TO LEARN MORE…**

**Navigating a liquidity crunch, regulatory complexity and downward pressure on costs**

8 April – 08:50-09:10



# Lucky 13 for TradeTech?

Where were you in 2001? Quendon Consulting's Richard Balarkas remembers it like it was yesterday, probably because surprisingly little has changed in the interim

The second day of TradeTech, which I have the pleasure of chairing this year, is usually laden with a sense of déjà vu. For many, the sense of "having been there before" is triggered by the annual ritual of a bleary-eyed awakening on a sunny day in Paris (not London) followed by a caffeine boosted trip out to La Defense to swap stories about the night before. For others, the sense of déjà vu may be triggered by the topics and themes covered by the speakers and the panellists. So many of the issues with which the industry is grappling in 2014 would have been very familiar in 2001 when a relatively small gathering of buy-side traders and their somewhat new and shiny sell-side e-trading counterparts gathered for the first ever TradeTech.

From the buy-side traders' perspective, the number one issue remains liquidity. The markets may be faster, the electronic gizmos used to trade far more advanced, but relatively little progress appears to have been made in making the life of the buy-side block trader any easier. There are few tools available to help the buy-side find a 'natural' on the other side, and if a natural cannot be found, the ability of brokers to transfer risk has been reduced by limitations on capital. The risk of information leakage and alpha destruction is ever present.

"The risk of information leakage and alpha destruction is ever present."

## Change the model

For the sell-side, one of the key questions remains how to configure their coverage model to meet the changing appetites of a more diverse and more discerning client base. Back in 2001, as the blue touch paper was being lit under electronic trading, there were a number of TradeTech attendees who, with unseemly haste, eagerly announced the imminent demise of the sales trader. The role of the sales trader has undoubtedly changed, but if anything it is now more important to many buy-side traders than ever before.

Unfortunately it is not just changing client needs that require brokers to review their coverage models. Whilst 2014 has seen a welcome boost in trading activity, just as in 2001 – which witnessed the aftermath of the dot com bubble – revenues and margins are under stress. Major indices may be reaching record highs and the IPO calendar may be looking healthier, but volumes remain a long way short of the level on which many brokers' business models are predicated.

## Change the rules

Regulation, as ever, remains a topic people are keen to hear about; understanding the future direction of rules and policy remains as important to developing a business strategy for the equity market in 2014 as it was in 2001. I suspect that as most firms write up their SWOT analysis on a flip chart the impact of regulation is rarely listed anywhere other than in the quadrant with the title 'threats'.

In Europe, there still appears to be a desire to seek retribution from the financial sector for the damage caused to society by the crisis. Ideas like the financial transaction tax (which will be paid by Joe Public, not the banks), are as misguided as the policies that allow the Greeks to avoid paying taxes, and the Vatican Bank to operate with the financial integrity of a developing nation in sub-Sahara. Nevertheless, those in authority who claim the moral high ground have decided that financial activity that cannot be associated with a social good should be discouraged.

There are some who might argue that any regulatory policy that produces no evident benefit to society should also be discouraged. Martin Wheatley, the CEO of the UK's Financial Conduct Authority, pointed out in a speech last Autumn that the dramatic expansion in the size of its rule book between 2001 and 2008 appears to have been inversely correlated to the efficacy of the regulatory system. Writing more and more rules is not, it seems, the way to address the problems seemingly endemic in the financial services industry.

## Change the record

The centuries of man hours that must have been dedicated to debating, monitoring and implementing the regulatory agenda of initiatives like MIFID, MIFID II and MIFIR seem an appalling price to pay when one considers the fact that the most tangible difference made so far is the removal of concentration rules in those few countries that had legislated to support the monopoly of their national exchanges. Regulatory policy has not managed to deliver a consolidated tape in equities, arguably making equity market regulation more difficult than it was. Meanwhile 'markets' like FX have until recently escaped any serious regulatory scrutiny (Am I the only person who baulks at FX spreads and commissions? Don't regulators do international travel?).

So much for the march of progress. Whilst few of the attendees in 2001 would have dared hazard a guess at the content of the TradeTech agenda in 2014, I feel somewhat more confident in my ability to guess what might be on the agenda in 2027.

## TO LEARN MORE …

**Chair's opening remarks**
9 April – 09:10-09:20

**Exploring the factors likely to affect the world of capital markets and your trading strategies**
9 April – 09:20-09:50

**Are equity markets serving their original purpose and what might the future hold?**
9 April – 09:50-10:10

**Can markets be made more efficient and fair or should they be left to evolve naturally?**
9 April 11:50-12:10

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Françoise César
+44 (0) 20 7397 3821
francoise@thetrade.ltd.uk

Marc Carolissen
+44 (0) 20 7397 3807
marc.carolissen@thetrade.ltd.uk

Nick Kidson
+44 (0) 20 7397 3822
nick.kidson@thetrade.ltd.uk

# Will big data save TCA or destroy it?

Faster and more sophisticated, but thwarted by intractable limitations, TCA pioneer Robert Kay considers the future of execution performance measurement

Since its inception more than 30 years ago, transaction cost analysis (TCA) has suffered from two core problems. First, market interactivity means that it is impossible to look at a single trade in isolation – its very execution, partial execution or non-execution, impacts other trades and market behaviour. Second, the cost of trade, order and market data collection and analysis is often seen as high relative to the quantifiable impact of improved execution performance on portfolio returns.

The explosion of market and transaction data resulting from liquidity fragmentation threatened to make cost effective TCA virtually impossible for a while. However, that did not prove to be the case. The evolution of big data capabilities, whether storage, access or processing has allowed services to emerge that give real-time access to terabytes of data.

## Immediate analysis

The demand for and delivery of real-time TCA has moved the industry into a new and exciting arena. Traders can now see the analysis of their activity appear even as the trade is being completed. The performance of algorithms can be analysed and adjusted to reflect the signs coming from the analysis. Focus can be quickly brought onto the trades that really matter, not only because they are very large but also because they are deviating significantly from expectation. This has transformed the nature of discussions between buy-side traders and sell-side firms, with electronic trading at the vanguard of a new dialogue.

The 'TCA and New Trading Tools' stream at this year's TradeTech will be looking at developments in this area and offering insights into how traders are exploiting new opportunities to deliver superior performance. In this sense, big data may have saved TCA from extinction by allowing it to move into a new and attractive phase.

> "The delivery of real-time TCA has moved the industry into a new and exciting arena."

However there should be no illusions that everything is now solved. The two core problems still remain. When each trade can be looked at in terms of the size, time and price of dozens of child orders executed on many different venues, then the genuine uniqueness of each order is put into sharp relief. There really is no comparison that can be legitimately made between one trade and any other. The same applies at a portfolio, trader or broker level. How can lessons be learned and performance improvements made if there is no way of creating statistically valid comparisons?

A look at costs versus benefits delivers similar stark conclusions. Changes in market structures and technology mean that differences are measured in microsecond latency changes and minimal price improvement opportunities. If you conclude that one child order could have been executed at a marginally better price, how much actual money would really have been gained and how does that compare with commissions, other charges and the return on the underlying portfolio? For traditional buy-side firms in particular, the effect remains hard to quantify and the expense may be difficult to justify.

> "How can performance improvements be made if there is no way of creating statistically valid comparisons?"

Regulatory and client pressure on transparency may make use of TCA services inevitable. However, TCA has always sought to be a decision-support tool for traders, not a 'tick-box' exercise for compliance.

## Last throw of the dice

So the new analysis is faster, more sophisticated and more granular than ever before and that will be rightly seen as a good thing. Answering the question of whether one trader is better than another and why will remain difficult if not impossible. The same applies to the analysis of executions done by one broker or another or the evaluation of one algorithmic trading suite compared with another. Where differences are identified, their quantum may not be sufficient to support business change. If with this level of speed and sophistication the analysis proves difficult to make useful, then big data may in fact be the final throw of the dice for TCA; heralding its demise rather than its transformation.

Panellists at TradeTech may be expected to take an optimistic view and should certainly be encouraged to do so. Technology has transformed trading over the last 15 years in ways that are generally regarded as beneficial by most interested parties on the buy-side or sell-side. Costs are generally lower, liquidity has been enhanced and new trading techniques have transformed the productivity of traders and the consistency of outcomes. These are accomplishments that TCA should be confirming on a day-to-day basis using generally accepted techniques and repeatable results. That would allow better comparisons to be drawn at all points in the execution chain from trader, through algorithm, sell-side and venue. The challenge for the panellists is to explain how that is already beginning to happen and how they expect to influence further improvements and enhancements going forward. Meaningful efforts in this direction will make for a series of stimulating sessions. ●

*Robert Kay is surveys editor at Asset International*

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**Next generation TCA and performance analysis: Using the right metrics to build a true picture of broker and trader**

9 April – 14:00-14:20

**Flash panel – Are traders measuring TCA effectively? How can accuracy and results be improved?**

9 April – 14:20-15:00

**Examining the challenges and requirement for dark and lit liquidity: what are the buy-side really looking for?**

9 April – 15:30-16:00

**TCA value or distraction: Getting to the heart of transaction cost**

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